City of Norfolk
Office of the City Manager

cc: Director of Finance

September 30, 2003

To the Honorable Council
City of Norfolk, Virginia

Re: Series 1994 General Obligation Refunding Bonds

Lady and Gentlemen:

The City currently has $50,820,000 (current market value) in General Obligation Refunding bonds that would create net present value savings comparable to prior traditional refundings. Federal tax law, however, allows only one advance refunding of bonds issued after 1986 thus prohibiting an advance refunding at this time.

As an alternative to a traditional refunding, the City is proposing to enter into a swap agreement with a highly rated counterparty as part of a transaction known as a "swaption". Interest rate swaps and other derivative instruments are increasingly being used in the municipal market to improve borrowing strategies. Generally, rating agencies believe that prudent use of derivatives – including interest rate swaps – can be an effective tool in meeting funding needs and managing a balance sheet while limiting risk.

The attached ordinance approves the City Manager entering into a swaption, which is to sell an Option (Right) to a third party (referred to as a "counterparty") to facilitate a floating to fixed interest rate swap agreement in the future.

If the counterparty exercises the option, the City would then issue general obligation, variable rate refunding bonds. These bonds would be sufficient to refund (on a current refunding basis) the Series 1994 Refunding Bonds and enter into a floating to fixed interest rate swap with the counterparty. Under this transaction, the City synthetically creates a fixed interest rate by "swapping" variable and fixed interest rate payments with the counterparty. Since these variable rate bonds will be refunding bonds, public hearings are not required. Once executed, the City's future debt service payments on the 2004 Variable Rate Refunding bonds and the related swap agreement will in most cases match that of the existing Series 1994 General Obligation Refunding Bonds.

The City will receive from the counterparty an upfront payment for the purchase of the option. As in traditional refundings, the City will only proceed if savings generated by the transaction reaches a minimum present value savings threshold. The ordinance provides for an estimated minimum present value savings of three percent before execution. This would equal an estimated upfront payment of approximately $1.5 million.

R-9

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As with many financial transactions there are risks and mitigating strategies that need to be considered. Some considerations for this transaction include:

Risk	Definition	Mitigation Techniques
Interest Rate Risk	Risk that interests rates rise and fall, changing the benefits and/or economics of a swap transaction once executed.	Consistent with historical practices we set a trigger transaction threshold of three percent present value savings before execution.
Basis Risk	Risk that indexes used to make swap payments are not equal to payments on related bonds to the swap.	We will carefully select indexes based on history of performance, trading differentials and quantify magnitude of possible divergence between a swap index and a bond rate.
Tax Risk	Risk that a change in tax laws causes a change in the relationship between tax-exempt and taxable rates. This relationship may impact the value of a swap and its cash flows	We will construct the swap agreement using a tax-exempt index instead of a taxable index.
Counterparty Credit Risk	Risk that the Counterparty will be downgraded or fail to make payments to the City when due.	The ordinance sets criteria for dealing with highly rated credit counterparties and we will also monitor on-going credit quality of counterparties.
Termination Risk	Risk that the swap is terminated early and the City has to unwind the swap in an unfavorable market and must make a termination payment.	In our agreement we will limit events of termination.

Using these guidelines, we believe we have constructed a fiscally responsible transaction that takes advantage of current favorable market conditions.

Recommendation: Adopt Ordinance

Respectfully submitted,

Regina V.K. Williams

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Form CCO-002

09/25/03 sn BAP

Form and Correctness Approved:

By [signature]
Office of the City Attorney

Contents Approved:

By [signature]
DEPT.

NORFOLK, VIRGINIA

Pursuant to Section 72 of the City Charter, I hereby certify that the money required for this item is in the city treasury to the credit of the fund from which it is drawn and not appropriated for any other purpose.

$ N/A   N/A
Account

[signature]
Director of Finance   9/25/03
Date

ORDINANCE No.

AN ORDINANCE AUTHORIZING THE ISSUANCE AND SALE OF UP TO $65,000,000 IN VARIABLE RATE GENERAL OBLIGATION REFUNDING BONDS TO REFUND CERTAIN PREVIOUSLY ISSUED BONDS OF THE CITY OF NORFOLK AND AUTHORIZING THE SALE BY THE CITY OF NORFOLK OF AN OPTION TO ENTER INTO AN INTEREST RATE SWAP AGREEMENT IN CONNECTION WITH SUCH REFUNDING BONDS

WHEREAS, on March 17, 1994, the City issued its $182,685,000 General Obligation Capital Improvement and Refunding Bonds, Series 1994 ("1994 Bonds);

WHEREAS, the Council of the City (the "Council") has determined that, based on current market conditions, net present value debt service savings (expressed as a percentage of refunded par) comparable to levels achieved by the City in connection with prior refundings of City general obligation bonds could be achieved in connection with the refunding of all or a portion of the 2005 through 2011 maturities inclusive of the 1994 Bonds (the "Refunding Candidates") but for the advance refunding limitations imposed by federal tax law which prohibit the issuance of bonds to refund a substantial portion of the

Refunding Candidates more than 90 days in advance of their June 1, 2004 optional call date;

WHEREAS, the Council has determined that it is advisable to authorize the City to undertake to achieve the economic equivalent of refunding the Refunding Candidates under current market conditions by selling an option (the "Swaption") to a financial institution counterparty (the "Counterparty") to cause the City to enter into a forward swap agreement (the "Swap");

WHEREAS, the Council has determined that it is advisable to authorize the borrowing of up to $65,000,000 and the issuance of variable rate general obligation bonds of the City ("Bonds") in the spring of 2004 to provide funds to refund all or a portion of the Refunding Candidates; provided, however, that the Bonds authorized under this Ordinance will not be issued unless the Swaption is exercised by the Counterparty;

WHEREAS, in connection with the Swap, which would take effect approximately concurrent with the issuance of the Bonds, the City would pay a fixed interest rate payment to the Counterparty netted versus a variable interest rate payment from the Counterparty to the City structured to be applied against the variable interest rate payments to be paid by the City on the Bonds;

WHEREAS, the premium the City would receive from the sale of the Swaption that when compared with the aggregate par amount of the Refunding Candidates would be comparable to the percentage of net present value debt service savings that the City has received from prior refundings of its general obligation bonds; and

WHEREAS, no public hearing is required on the Bonds under the Virginia Code because they will be refunding bonds; now, therefore,

BE IT ORDAINED by the Council of the City of Norfolk:

Section 1:- That the Council determines that it is advisable to contract a debt and to issue and sell the Bonds in an original principal amount not to exceed $65,000,000. The issuance and sale of the Bonds in one or more series after the date the Swaption is exercised in accordance with the terms of this Ordinance is authorized and shall be styled "City of Norfolk, Virginia, Variable Rate General Obligation Refunding Bonds," with an appropriate series designation. The proceeds from the issuance and sale of the Bonds are hereby appropriated and shall be used to pay to refund all or a portion of the Refunding Candidates and may be used to pay costs of issuance, including without limitation, underwriter's discount and credit enhancement and liquidity facility fees.

Section 2:- That the full faith and credit of the City are irrevocably pledged for the payment of the principal of, premium, if any, and interest on the Bonds and the payment of the City's obligations under credit enhancement and liquidity facilities related thereto, the Swap and swap payment insurance relating to the Swap authorized in Section 3(n) below (collectively, the "Obligations"). The Council is authorized to and shall levy and collect annually, at the same time and in the same manner as other taxes of the City are assessed, levied and collected, a tax upon all taxable property within the City, over and above all other taxes authorized or limited by law, and without limitation as to rate or amount, sufficient to pay when due the principal of and premium, if any, and interest on the Bonds and the other Obligations to the extent other funds of the City are not lawfully available and appropriated for such purpose.

Section 3:- The Council, pursuant to Section 15.2-2626 of the Public Finance Act of 1991, Chapter 26 of Title 15.2 of the Code of Virginia of 1950, as amended (the "Public Finance Act") hereby finds and determines that the entering into the Swaption and Swap in accordance with this Ordinance is necessary and appropriate to place the obligations as represented by the Bonds on the interest rate basis desired by the Council. The Swaption and the Swap will be subject to the following provisions:

(a) The Counterparty which purchases the Swaption and enters into the Swap shall have a general credit rating of at least "Aa3" or "AA-" by one of Moody's Investors Services, Inc., Standard & Poor's Ratings Services or Fitch Ratings and not less than "A" by any of Moody's Investors Services, Inc., Standard & Poor's Ratings Services or Fitch Ratings, or have an "Aaa" or "AAA" rated subsidiary according to at least one of such rating services;

(b) The Swaption shall be non-assignable by the Counterparty without the City's consent;

(c) The fixed strike rate that the City shall pay to the Counterparty under the Swap Agreement (the "Strike Rate") shall not exceed 6.00% per annum;

(d) The premium to be paid by the purchaser of the Swaption to the City on an aggregate net present value basis shall equal or exceed 3% of the par amount of the Refunding Candidates to be refunded;

(e) The notional amount of the Swap shall not exceed $65,000,000;

(f) The notional amount of the Swap shall be amortized substantially identical to the projected amortization schedule for the Bonds;

(g) The term of the Swap shall not exceed the final stated maturity date of the Bonds;

(h) The payments to be made under the Swap by the Counterparty to the City shall be based on an index selected by the City Manager and recommended by the City's financial advisor and the City's Director of Finance as an effective means to manage basis risk;

(i) The Swaption shall not be sold until the City Manager makes the determination that based on the City's prospects to obtain liquidity/credit enhancement and other relevant factors, market-access for the City with respect to the Bonds is reasonably expected;

(j) The Swaption shall be sold pursuant to negotiation or competitive bid as the City Manager shall determine pursuant to such customary term sheet or other documentation as the City's financial advisor and Director of Finance shall recommend but subject to the City's Interest Rate Swap Policy (the "City's Swap Policy") and applicable procurement requirements;

(k) All Swap documents shall be based off currently accepted International Swap Dealers Association models;

(l) All other terms and provisions relating to the Swaption and the Swap shall be consistent with the City's Swap Policy;

(m) Swap insurance, which is hereby authorized, shall be obtained for the City's obligations under the Swap, unless the City Manager, upon the recommendation of the City's financial advisor and Director of Finance, determines that such insurance is not necessary; and

(n) Any settlement amounts to be paid by the City should the City be forced to terminate the Swap or exercise an option to terminate the Swap may be based off market conditions at the time of the election or termination, as the Swap documents shall provide.

Section 4:- That approval of refunding and redemption of the Refunding Candidates will be as follows:

(a) the Council approves the use of the proceeds of the Refunding Bonds to refund all or a portion of the Refunding Candidates to be selected by the City Manager upon the recommendation of the City's financial advisor and Director of Finance;

(b) the Bonds shall not be issued pursuant to the authorization contained in this Ordinance unless and until the purchaser of the Swaption exercises the right to cause the City to enter into the Swap;

(c) the Council authorizes and directs the City Manager and such officers and agents of the City as she may designate, in connection with the issuance of the Bonds, to call each of the Refunding Candidates to be refunded for optional redemption. The redemption proceedings, including the giving of redemption notices to the holders of the refunded Refunding Candidates, shall be done pursuant to the terms of the Refunding Candidates; and

(d) the City Manager is authorized to execute and deliver an Escrow Agreement between the City and an Escrow Agent to be selected by the City Manager providing for the irrevocable deposit of the proceeds of the Bonds in an amount sufficient, when invested in United States Treasury Securities as provided in accordance with the Public Finance Act and in the Escrow Agreement, to provide for the payment of the principal of and premium, if any, and interest on the Refunding Candidates to be refunded as determined by the City Manager or the Director of Finance.

Section 5:- That the Bonds shall be dated such customary date as shall be determined by the City Manager, shall be issued in fully registered form in denominations of $5,000 each or whole multiples thereof, may be issued at one time or from time to time in a single or multiple series (with appropriate series designation). The Bonds shall be issued in such principal amount, shall bear interest in such modes and at such rate or rates, payable at such times, and shall mature annually in such amounts as may be determined by the City Manager, provided that (i) the original aggregate principal amount of the Bonds shall not exceed $65,000,000, (ii) the interest rate for the Bonds shall be variable and shall not initially exceed 6.50% and shall in no event exceed

15% per annum, (iii) the total aggregate underwriter's discount related to the issuance and sale of any series of the Bonds shall not exceed one percent (1%) of the aggregate principal amount thereof, (iv) the final maturity of Bonds shall not be later than June 30, 2012, (v) the annual remarketing agent fees shall not exceed one-eighth of one percent (0.125%) and (vi) the annual fees for credit and/or liquidity support shall not exceed one percent (1%).

Section 6:- That the Bonds shall be in substantially the form of prior general obligation bonds of the City and filed in the City's records, with such appropriate variations, omissions and insertions as are permitted or required by this Ordinance. There may be endorsed on the Bonds such legend or text as may be necessary or appropriate to conform to any applicable rules and regulations of any governmental authority or any usage or requirement of law with respect thereto.

Section 7:- That the City Manager and the Director of Finance are authorized and directed to approve such optional and mandatory redemption provisions, conversion provisions, and optional and mandatory tender provisions with respect to the Bonds as she may deem advisable; provided that all Bonds, while in a variable interest rate mode, must be callable for optional redemption within six months of the date of issuance and no optional redemption premium shall exceed three percent (3%) of the principal amount of any Bonds to be redeemed.

Section 8:- That the City Manager is authorized to prepare one or more of a trust indenture, trust agreement, fiscal agency agreement, paying agent agreement and/or similar instrument with a financial institution to provide for details of the Bonds (the "Bond Documents"), including without limitation, tender, transfer, registration, redemption, conversion, credit and liquidity facility draw and payment provisions and other operational details customarily contained within, or relating to the administration of, variable rate bonds. The Bond Documents shall be prepared and finalized in consultation with the City Attorney, Director of Finance and the City's financial advisor and bond counsel.

Section 9:- That the Mayor, the City Treasurer and the City Manager are authorized and directed to execute the Bond Documents and the Bonds. The Clerk of the Council is authorized and directed to affix the seal of the City to the Bond Documents and the Bonds and to attest the seal. The manner of execution, attestation and affixation of the seal may be by facsimile; provided, however, that if the signatures of the Mayor, the City Treasurer, the City Manager and Clerk on the Bonds are all by facsimile, the Bonds will not be valid until signed at the foot thereof by the manual signature of the Bond Registrar, who has been appointed as provided in this Ordinance.

Section 10:- That the City Manager's approval or determination of the details and provisions of the Swaption, the Swap, the Swap documents, the Bond Documents and the Bonds that she has been authorized and/or directed to approve under this Ordinance shall be evidenced conclusively by her execution and delivery of the Bonds on the City's behalf.

Section 11:- That the Bonds may have CUSIP identification numbers printed on them. No such number will constitute a part of the contract evidenced by the Bond on which it is imprinted and no liability will attach to the City, or any of its officers or agents by reason of such numbers or any use made of them, including any use made by the City and any of its officers or agents, by reason of any inaccuracy, error or omission.

Section 12:- That the Swaption and the Bonds shall be offered for sale in such manner as the City Manager may determine to be in the best interests of the City. The City Manager and such officers and agents of the City as she may designate are hereby authorized and directed to prepare and deliver an appropriate, preliminary official statement, official statement and such other offering or disclosure documents as either of them may deem necessary to effect the sale of the Swaption and the Bonds. The City Manager is authorized and directed to execute such offering or disclosure documents. The City Manager is hereby authorized and directed, after consultation with the City Attorney, the Director of Finance, and the City's financial advisor and bond counsel, to enter into, as appropriate, such bond purchase agreements, remarketing agreements, tender agent agreement, credit or liquidity facility documents and auction rate security documents as she may deem necessary in connection with the sale, resale or remarketing of the Swaption and the Bonds. The preliminary official statement or statements, official statement or statements or other documents shall be published in such publications and distributed in such manner and at such times as the Director of Finance shall determine. The City Manager is authorized and directed to deem the preliminary official statement "final" for purposes of Securities and Exchange Commission Rule 15c2-12 (the "Rule").

Section 13:- That the appropriate officers and agents of the City are authorized and directed to execute and deliver simultaneously with the issuance of the Bonds a Non-Arbitrage Certificate and Tax Compliance Agreement setting forth the expected use and investment of the proceeds of the Bonds and containing such covenants as may be necessary in order to comply with the provisions of the Internal Revenue Code of 1986, as amended ("Tax Code"), including the provisions of Section 148 of the Tax Code and applicable regulations relating to "arbitrage bonds." The Council agrees on behalf of the City that the proceeds from the issuance and sale of the Bonds will be invested and expended as set forth in the City's Non-Arbitrage Certificate and Tax Compliance Agreement and that the City will comply with the other covenants and representations contained in it.

Section 14:- That the City Manager is authorized and directed to execute and deliver simultaneously with the issuance of the Bonds a Continuing Disclosure Agreement, in substantially the form of previous such agreements delivered by the City and filed in the City's records, setting forth the reports and notices to be filed by the City and containing such covenants as may be necessary in order to comply with the provisions of the Rule, to the extent applicable, with respect to the Bonds.

Section 15:- That the Council hereby authorizes the City Manager to select, the bond registrar, trustee, paying agent and similar agents for the Bonds under such provisions and with such duties as may be set forth in the Bond Documents.

Section 16:- That the City Manager and such other officers and agents of the City as the City Manager may designate, are authorized and directed to take further action as they deem necessary or appropriate regarding the issuance, liquidity/credit enhancement and sale of the Bonds, including the preparation, execution and delivery of instruments, agreements and documents related to the issuance and sale of the Bonds, the purchase of municipal bond insurance or other liquidity/credit enhancement for any series of the Bonds if market or other conditions so warrant, and the acquisition of forward purchase or supply arrangements relating to the investment of the proceeds of the Bonds and the selection of one or more underwriters, escrow agents, verification agents, remarketing agents, tender agents, broker-dealers and auction agents. All actions taken by officers and agents of the City in connection with the issuance and sale of the Bonds are hereby ratified and confirmed. The authorizations granted in this Ordinance to the Mayor and City Manager may be carried out by the Vice Mayor or any Assistant City Manager, as appropriate, in the absence of the primary officers.

Section 17:- That the officers and agents of the City are authorized and directed to take such further actions as they deem necessary regarding the issuance and sale of the Bonds and all actions taken by such officers and agents in connection with the issuance and sale of the Bonds are ratified and confirmed.

Section 18:- That the appropriate officers or agents of the City are authorized and directed to file a certified copy of this Ordinance with the Circuit Court of the City pursuant to Sections 15.2-2607 and 15.2-2627 of the Virginia Code of 1950, as amended.

Section 19:- That the Council hereby elects pursuant to Section 15.2-2601 of the Virginia Code to issue the Bonds under the Public Finance Act without regard to the requirements, restrictions or other provisions contained in the Charter of the City.

Section 20:- That this Ordinance shall take effect from and after its adoption. The authorizations set forth herein shall expire if the Bonds are not issued on or before December 31, 2004.